BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
GIBSON WINE CO, )

Appearances:

For Appellant: Jefferson E. Peyser, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

## O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Gibson Wine Co. to proposed assessments of additional franchise tax in the amounts of $9,254.44 and $2,036.07 for the income years ended July 31, 1946, and July 31, 1948, respectively.

Gibson Distributing Company, a partnership, was organiaed about 1933, with its principal place of business in Cincinnati, Ohio, Mr. R. H. Gibson held the majority partnership interest. The partnership engaged in business in Ohio, Kentucky, West Virginia, and Indiana. It purchased bulk wines and bottled them under a number of its own labels. It also purchased and distributed imported wines, imported champagnes, bottled California wines, and various related items.

On or about April 22, 1944, the partnership acquired the capital stock of two California corporations, Sunny Crest Winery and St, Francis Winery. These corporations were dissolved and their assets were turned over to the partnership, On or about July 17, 1944, the partnership incorporated the Cal-O-Ky Winery Company under the laws of California. On August 1, 1944, the partnership incorporated the Gibson Wine Company under the laws of Nevada, The partnership transferred all of its assets to the Nevada corporation. The Nevada corporation then acquired all of the stock of the Cal-O-Ky Winery Company for $100,000. A winery at Elk Grove, California, which had been acquired by the parent uorporation through its acquisition of the Sunny Crest Winery, was sold to the Cal-0-Ky Winery Company. The name of Cal-0-Ky Winery Company was changed

to the Gibson Wine Co,, the Appellant in this appeal;

The parent corporation engaged in the same bottling and distribution business as had the partnership, its predecessor, handling a wide variety of domestic and imported merchandise4 Appellant engaged primarily in the production of bulk wines.

During the year ended July 31, 1946 the parent corporation purchased 1,204,000 gallons of bulk wine of which 409,000 gallons were purchased from Appellant, During the year ended July 31, 1948, the parent corporation purchased 1,237,293 gallons of bulk wine of which 838,522 gallons were purchased from Appellant,

Practically all of Appellant's sales were to the parent corporation, Total sales of Appellant for the year ended July 31, 1946, were $288,772.22 of which $282,028.04 were sales to the parent. Total sales for the year ended July 31, 1948, were $351,828.10 of which $339,822.11 were sales to the parent. Appellant sold the wines to the parent at the prevailing market price for similar wines. The parent corporation did not market any of its products in California,

Total sales of the parent for the year ended July 31, 1946, were $5,092,094.17 and its net profit as shown on its separate accounting records was $1,446,078.83. Appellant's net profit as shown on its records for that year was $20,482.00. Total sales of the parent for the year ended July 31, 1948, were $3 265,462.84. and its net profit as shown on its records was $37 ,244.50. Appellant's records showed a loss for that year of 398,480.07.

Mr, R.H. Gibson "and family" owned 75 percent of the stock of the parent corporation, He was a director of the parent corporation and a director of Appellant and was also president of both corporations, With the exception of Mr. Gibson, Appellant had different officers than the parent corporation. Appellant maintained its own records and purchased its own materials, and the operations of the two corporations were conducted by different personnel,

Por the year ended July 31, 1946, wine inventory valued at $550,550.49 owned by the parent corporation was stored at Appellant's warehouse. These wines were purchased by the parent corporation from another winery and were sent to Appellant's winery for storage during a finishing process before being sent on to the parent corporation for bottling and sale, For the year ended July 31, 1948, wine inventory valued at $465,426.02 owned by the parent was similarly stored at Appellant's warehouse.

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The parent corporation qualified to do business in California in 1944 and withdrew from the State in 1946. It filed blank returns stating it did no business here, For the years in question Appellant filed its returns on a separate accounting basis.

The Franchise Tax Board determined that Appellant and its parent, the Nevada corporation, were conducting a unitary business. Accordingly, under Section 10 of the Bank and Corporation Franchise Tax Act (now Section 25101 of the Revenue and Taxation Code), it combined the net income of the two corporations and by us8 of the property-payroll-sales allocation formula allocated to California 21.47 percentof the combined net income for the year ended July 31, 1946, and 24.87 percent of such income for the year ended July 31, 1948. It included the inventory which was owned by the parent and stored in Appellant's warehouse as California property in the property factor.

Appellant contends that the Franchise Tax Board's action was erroneous on the grounds that (1) the business conducted by Appellant and its parent did not constitute a unitary business, (2) *even* if that business were unitary the application of the three factor formula results in allocation of an unreasonable percentag e of income to California, and (3) the percentagesused in computing the formula were improper.

The first question for decision is whether the business of Appellant is to be considered as a separate business or as a portion of a unitary business conducted by Appellant and its parent, the Nevada corporation.

> "The essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship, the business is unitary. If there is no such relationship, then the business in the state may be considered separate and the income therefrom may be determined without reference to the success or failure of the taxpayer's activities in other states.
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> "Whether or not a particular businese conducted by a particular taxpayer falls into one category or the other must depend on the manner in which the particular businessis conducted. Certain general classifications may, however, be made. For example, the business of manufacturing or purchasing goods in one state and selling them in other states is clearly unitary." (Underscoring added,) Altman & Keesling, Allocation of Income in State Taxation, 2nd Edition, p. 101.

Equally pertinent are the following excerpts from the Bank and Corporation Tax Regulations, 18 California Administrative Code, Chapter 3, Subchapter 3.

> "A typical unitary operation is one in which the taxpayer manufactures in one state and sells such products in other states." Reg. 24301.
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> "Where a unitary business is owned and controlled by the same interests, regardless of whether it is conducted in the name of two or more corporations, ... the income from the entire unitary business will first be determined as if the business had been conducted in the name of one corporation, The portion of the unitary income derived from or attributable to California will be determined by means of a formula." Reg. 24303-24304,

The courts have held consistently that the business of manufacturing or purchasing goods and selling them, whether conducted through one or more corporations, is to be regarded as unitary. Butler Brothers v. McColgan, 315 U.S. 501, 508; Underwood Typewriter Co. v. Chamberlain 254 U.S. 113; Bass, Ratcliff & Gretton Ltd. v. State Tax Commission, 266 U.S. 271; Edison California Stores v. McColgan, 30 Cal. 2d 472; John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214. In this regard it is noted that Appellant has not called our attention to any decision in which a contrary result was reached,

In the appeal of The Youngstown Steel Products Company of California, May 29, 1953, this Board found a manufacturing and selling business to be unitary where the manufacturing corporation sold to the selling corporation on the same basis with respect to discounts and prices as it sold to independent distributors! and thus, as in this case, dealt with the selling corporation at prevailing market prices.

It has been pointed out in Butler Brothers v. McColgan, supra, and Edison California Stores v. McColgan, supra, that the unitary nature of a business is "definitely established by (1) unity of ownership; (2) unity of operation evidenced by central purchasing, advertising, accounting and management; and (3) unity of use in the centralized executive force and general system of operation." No question arises in this case as to the existence of the unity of ownership. We cannot agree with Appellant's contention that unity of ownership is the only unity present here. Unity of opera tion sufficiently appears, in our opinion, in the sale by Appellant of

its bulk wines exclusively, for all practical purposes, to the parent, and in the storing and finishing of wines owned by the parent in Appellant's warehouse.

Unity of use in the centralized executive force and general system of operation is demonstrated, we believe, in the circumstances surrounding the formation of the parent corporation and of Appellant and in the control of both corporations lodged in Mr. Gibson, The same executive group brought about the formation of both corporations and it seems clear that Appellant was organized to supply bulk Wines to the parent, Mr. Gibson and his family owned 75 percent of the stock of the parent corporation which in turn owned all of the stock of Appellant, Having this controlling ownership interest and being president and a member of the bbard of directors of both corporations, it is apparent that Mr. Gibson was in control of the operations of both corporations,

In light of the foregoing tests and authorities, it is our opinion that Appellant has failed to establish that its business was separate rather than a part of a unitary enterprise.

In its second objection Appellant argue8 that even if this were a proper case for application of the formula, the property-payroll-sales formula results in allocation of an unreasonable percentage of income to California and therefore results in taxation by this State of extraterritorial values, Appellant bases this argument on the fact that whereas over 20 percent of the income has been allocated here, Only a small percentage of the sales are allocable here.. This argument ignores the other factors, particularly the high percentage of property, attributable to California. Appellant states that a more equitable allocation would be obtained by use of a formula of wages, sales, and purchases.

A somewhat similar argument was presented to the court in El Dorado Oil Works v. McColgan, 34 C, 2d 731. There the taxpayer purchased the bulk of its supplies in the Philippine Islands where it maintained offices for that purpose. As against the taxpayer's contention that purchases should be included as a factor in the allocation formula the court upheld the three factor formula of sales, payroll and property, on the ground that the broad language of the statute empowered the commissioner in his discretion to Choose such factors for use in the allocation formula as will achieve a proper apportionment of business done within and without the state, The fairness of this formula as applied to the type of business here involved is no longer open to debate. Butler Bros. v. McColgan, supra; John Deere Plow Co. v. Franchise Tax Board, supra; Edson California Stores v. McColgan, supra,

Appellant% third objection, that the percentages used in computing the formula were improper, is based on an argument that the parent's *wine* inventory stored and processed in Appellant's warehouse is not properly included as California property in the property factor but should be included as out-of-State property, It is Appellant's contention that this inventory may be considered as in transit to the parent corporation and may not properly be considered as having its situs in California, We cannot agree with this contention. The storage of this inventory in Appellant's warehouse was not a temporary interruption in its interstate journey for lack of facilities for immediate transportation, but instead was for the parent's own purposes. Accordingly, the inventory was not in transit in interstate commerce and had situs in this State for tax purposes, Yellow Cab Manufacturing Company v. The City of San Diego, 106 Cal. App. 587. This inventory was properly included as California property in the formula used to allocate the unitary income to sources within and without the State,

Since the apportionment between Appellant and its parent corporation of the unitary income allocated to this State is not in issue, we have not considered that question,.

In view of the above considerations we conclude that the action of the Franchise Tax Board must be sustained,

## O R D E R

Pursuant to the views expressed in the opinion of the Board on file *in* this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code that the action of the Franchise Tax Board on the protests of Gibson Wine Co. toproposed assessments of additional tax in the amounts of $9,254.44 and $2,036.07 for the income gears ended July 31, 1946, and July 31, 1948, respectively, e and the same is hereby sustained.

Done at Los Angeles, California this 22nd day of June, 1956, by the State Board of Equalization.

Robert E. McDavid, Member

Robert C. Kirkwood, Member

Paul R. Leake, Chairman

Geo. R. Reilly, Member

J. H. Quinn, Member

ATTEST: Dixwell L. Pierce, Secretary